U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF CHIEF COUNSEL FOR ADVOCACY



May 16, 1996

**BY HAND**

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, Room 222
Washington, D.C. 20554



**Re: CC Docket 96-98**

Dear Mr. Caton:

The Office of Advocacy of the Small Business Administration transmits herewith the original and 16 copies of its comments in response to the Notice of Proposed Rulemaking in the above-referenced docket. Included with this package is a duplicate "file copy" of this pleading. Please date stamp this copy and return it to the messenger delivering this filing.

Thank you in advance for your assistance in this matter. If you have any questions, please contact me or David Zesiger at 202/205-6532.

Respectfully submitted,

Jere W. Glover
Chief Counsel

Enclosures

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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| Implementation of the Local Competition Provisions in the Telecommunications Act of 1996 | ) | CC Docket No. 96-98 |
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# Comments of the Chief Counsel for Advocacy of the United States Small Business Administration on the Notice of Proposed Rulemaking

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**SUMMARY**

Small competitors will play a significant role in realizing the Telecommunications Act of 1996's goal of introducing competition in the local exchange market. It is therefore vital that the Commission's rules implementing the local competition provisions of the 1996 Act affirmatively take into account small competitors' needs. By doing so, the Commission will maximize competition and encourage entry by a significant class of potential competitors.

National rules are not only a justified exercise of the Commission's authority under the Telecommunications Act of 1996 but are also necessary to facilitate small competitors' entry into local exchange competition. If the Commission is to develop national rules, however, such rules must incorporate procedural mechanisms to provide simple and timely relief for small businesses or otherwise run a very substantial risk of working a hardship on significant numbers of small competitors.

The duty to negotiate in good faith is a vital safeguard, particularly for small businesses. For this duty to have any real meaning, however, the Commission's rules must contain explicit compliance and enforcement mechanisms to protect competitors, and especially small competitors.

The interconnection, collocation and unbundling provisions of the Telecommunications Act of 1996 represent the heart of the pro-competitive portion of the Act. The Commission should promulgate national rules and standards for these requirements that give real meaning to these provisions and offer real procedural safeguards for small competitors. Pricing of these elements should be based on a forward looking cost basis using a TSLRIC methodology. Proxy-based methodologies are inherently unfair to smaller incumbent LECs whose real costs often do not match a proxy model's estimation.

Section 252(i)'s requirement that LECs make available element(s) of previously approved agreements to other requesting carriers is particularly important to small competitors' hopes of entering local market segments. Smaller competitors must not be forced to pay for unwanted elements when choosing element(s) from previously approved agreements. The Commission should adopt national standards for resolving conflicts under section 252(i).

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The Office of Advocacy of the Small Business Administration respectfully submits the following comments in the above-captioned proceeding. The proceeding will implement the local competition provisions of the Communications Act of 1934, as amended by the Telecommunications Act of 1996 ("1996 Act" or "Act").[1]

## I. BACKGROUND

The Telecommunications Act of 1996 changed the fundamental premise of telecommunications regulation. Prior to the 1996 Act, local exchange carriers were generally assumed to be natural monopolies and were subject to monopoly regulation by the Commission and the states. However, with the rapid pace of

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[1]Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996)(hereinafter 1996 Act).

technological change, an increasing number of new entrants began to offer services in competition with local exchange carriers (LECs). States have experimented with a variety of new competitive models to allow local exchange competition.

The 1996 Act formalized this shift to a competitive paradigm by enacting a series of requirements that were designed, *inter alia*, to open the local exchange market to a wide variety of new sources of competition. New sections 251, 252, and 253 of the 1996 Act represent the heart of this new competitive policy, which sections are the subject of the Notice of Proposed Rulemaking in the instant docket.[2] Consistent with the 1996 Act's overriding emphasis on competition, the Office of Advocacy will address issues raised in the Notice that affect small businesses, chiefly smaller telecommunications competitors.

## II. THE ROLE OF SMALL COMPETITORS

All sections of the Notice should include provisions that reflect small businesses' needs as they enter local competition. The Commission will further the underlying goals of the 1996 Act by choosing interconnection, unbundling and resale rules that facilitate new small business entrants into the local exchange

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[2] *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, Notice of Proposed Rulemaking, FCC 96-182, CC Docket No. 96-98 (rel. April 19, 1996) (hereinafter "Notice").

market. Otherwise, competition will be restricted to the same few larger companies that have traditionally dominated this market.

Maximizing openness and competitiveness and reducing barriers to entry is not only the overriding purpose of the 1996 Act, it is also clearly in the long-run best interest of small competitors. If it is true that lowering market entry barriers favors all businesses, it is even more true that lowering these barriers will disproportionately favor small businesses. Smaller competitors are particularly vulnerable to indirect entry barriers that cause delay, raise transactional costs and otherwise impose economically inefficient constrainsts on entry. Unlike larger competitors, small businesses cannot afford to navigate the complex regulatory process or overcome the resistance of reluctant incumbents. What might be a manageable obstacle for a larger business could well be an impenetrable barrier to entry for a smaller business.

As is already the case in the interexchange market, small competitors are likely to play an increasingly active role in the development of competition in the local exchange market. Smaller competitors are likely to fill countless market niche needs that larger competitors typically overlook. Without smaller competitors, competition might never reach numberous consumers.

To see how the Commission can best encourage small competitors to enter, we now proceed to a discussion of specific aspects raised by the Notice.

## III. THE SCOPE OF THE COMMISSION'S RULES

Section II.A. of the Notice raises the question of the scope of the Commission's regulations. The Notice states the Commission's intention "to adopt national rules that are designed to secure the full benefits of competition for consumers (emphasis added)."[3] The Office of Advocacy embraces this tentative conclusion as one of the most important the Commission could arrive at, not only to benefit consumers but also to address the needs of small telecommunications competitors.

The Office of Advocacy reaffirms the significant public policy goals cited in the Notice that will be maximized by adopting explicit national rules. National rules will, *inter alia*, simplify and expedite the entrance of new competitors, minimize confusion, reduce the capital costs of new entrants, allow for uniform network configurations, limit the incumbent's inherent bargaining advantage, and, generally, expedite the transition to competition, the overriding goal of the Act.[4]

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[3]Notice at para. 26.

[4]Notice at para. 28-32.

National rules will also serve the interests of small competitors. National rules will open markets to small competitors which typically have the fewest resources and the least experience in dealing with multiple jurisdictions' regulatory processes. National rules will also help small competitors offset the disproportionate leverage incumbent LECs enjoy in their dealings with new competitors by limiting their ability to dictate the terms of negotiations.

Of course, explicit national rules should not completely displace the states from their historic role in regulating intrastate telecommunications. Yet the 1996 Act clearly envisions a more active role for the Commission and expressly mandates federal rules and standards in many new areas. Clear national guidelines that set a floor for states will be the greatest asset for state commissions as they oversee the implementation of the Act. Beyond such guidelines, the Commission should also leave room for states to initiate additional protections for smaller entities (*e.g.* detailed compliance and enforcement mechanisms).

A case in point would be the voluntary negotiation of interconnection agreements prescribed in section 252. The Notice recognizes the incumbent LECs' disproportionate power: "By narrowing the range of permissible results, concrete national

standards would limit the effect of the incumbent's bargaining position on the outcome of the negotiations."[5] Without explicit national guidelines, the "voluntary" negotiations mandated by section 252 could turn out to be anything but voluntary for smaller entities. In this instance, if smaller entities are to do anything more than piggyback on previously negotiated agreements, it is incumbent upon the Commission to provide, clear, explicit national rules.

## IV. SIMPLIFIED AND EXPEDITED RELIEF

Section II.A. of the Notice, dealing with the scope of the Commission's rules, must be augmented to include an analysis of small competitors' needs. National rules that do not affirmatively take into account small business' needs are as likely to work an unintentional hardship on smaller competitors as they are to help them. Therefore, expedited relief processes to address small business concerns in a simple and timely fashion should be a part of any national rules the Commission might establish. This kind of small entity safeguard is particularly necessary for the interconnection, collocation, unbundling and resale rules where incumbent LECs have manifold incentives and opportunities to sidetrack smaller competitors who have little or no voice in the regulatory and negotiating processes.

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[5] Notice at para. 31.

Such a relief process would be in addition to the compliance and enforcement mechanisms for each rule and would be designed to provide relief when those mechanisms broke down. Such a small business "safety valve" would go a long way toward righting the balance between incumbent LECs and small competing carriers or resellers.[6]

## V. THE DUTY TO NEGOTIATE IN GOOD FAITH

Section II.B.1 of the Notice deals with the duty to negotiate in good faith. Subsection 251(c)(1) of the Act imposes on each LEC "the duty to negotiate in good faith in accordance with section 252 the particular terms and conditions of agreements to fulfill the duties described in [sections 251(b) and (c)]."[7] The Act also imposes a more general requirement on requesting LECs to negotiate in good faith. Subsection 252(b)(5) identifies as a failure to negotiate in good faith as "the refusal of any other party to the negotiation to participate further in the negotiations, to cooperate with the State commission in carrying out its function as an arbitrator, or to continue to negotiate in good faith in the presence, or with the

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[6]Such a procedural mechanism would also tend to demonstrate the Commission's compliance with the Regulatory Flexibility Act ("RFA") and insulate the Commission from judicial challenge under the recent amendments to the RFA. See, the Small Business Regulatory Enforcement Fairness Act of 1996, Pub. L. No. 104-121, 110 Stat. 857 (1996).

[7]1996 Act at sec. 101; sec. 251(c)(1).

assistance, of the State commission."[8]

The Office of Advocacy believes that establishing national guidelines regarding good faith negotiation is appropriate and consistent under the 1996 Act. The broad equitable duty imposed by paragraph 251(c)(1) will have little real meaning without substantive guidelines from the Commission and the states. As important to smaller businesses as national rules are for substantive issues such as interconnection and unbundling requirements, national rules are at least as important for procedural requirements such as the duty to negotiate in good faith.

As vulnerable as larger competitors can be to prejudicial procedural behavior by monopoly providers, small businesses are typically even more so. Small businesses generally lack the resources necessary to deal with unfair procedural requirements. For example, delaying tactics, while prejudicial even to the largest competitors, can often be fatal to small competitors. Onerous up-front deposit requirements, penalty clauses or other procedural requirements fall disproportionately hard on small businesses. Moreover, small businesses will typical not be in a position to exert significant leverage on incumbent LECs.

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[8]1996 Act at sec. 101; sec. 252(b)(5).

The Commission's rules should, therefore, contain explicit compliance mechanisms to give meaning to the general duty to negotiate in good faith. The rules should also prohibit behavior clearly intended to disadvantage competitors. The Notice references two obvious examples of this kind of clear violation of the duty to negotiate in good faith (requiring non-disclosure agreements and limitations on legal remedies to begin negotiations).[9] Finally, the rules should include enforcement mechanisms, including financial penalties for violations.

As in other areas, explicit national rules should not completely displace the states' role in overseeing parties' conduct in negotiations. National guidelines should provide states and parties with basic minimum standards that would place simple and clear limits on the negotiating process. This will greatly reduce negotiators' uncertainty and ultimately speed the negotiations.

## VI. INTERCONNECTION

Section II.B.2.a. of the Notice addresses the interconnection provisions of section 251. Section 251(c)(2) imposes upon incumbent LECs "[t]he duty to provide, for the facilities and equipment of any requesting telecommunications

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[9] Notice at para. 47.

carrier, interconnection with the local exchange carrier's network ... for the transmission and routing of telephone exchange service and exchange access..."[10] Section 251(c)(2) further requires that interconnection be provided "at any technically feasible point" and that it must be "at least equal in quality" to the LEC's own service.[11] Section 251(c)(2)(D) requires that interconnection be offered "on rates, terms and conditions that are just, reasonable, and nondiscriminatory."[12]

The interconnection provisions in the 1996 Act represent the cornerstone of the Act's pro-competitive policy. The Commission's implementation of these provisions will do more to ensure the rapid development of competition in the local exchange market than in any other area of the 1996 Act.

The Office of Advocacy supports the Notice's tentative conclusion that "uniform interconnection rules would facilitate entry by competitors..."[13] National rules for interconnection would advance a number of important policy goals, including speeding negotiations, minimizing disputes, reducing confusion and uncertainty, and achieving technical uniformity. Such rules

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[10]1996 Act at sec. 101; sec. 251(c)(2).

[11]Id.

[12]Id.

[13]Notice at para. 50.

would also help states handle their duty to oversee negotiations and resolve arbitrations. Finally, for all these reasons, national rules would materially improve small competitors' ability to compete to provide a wide variety of services.[14]

Existing interconnection agreements between incumbent LECs offers a reliable measure of what rates, terms and conditions are "just, reasonable and nondiscriminatory". Since neither of the parties to most of these agreements were in direct competition with each other, there was virtually no incentive to charge the interconnecting party other than economic cost or to impose anticompetitive terms and conditions. Such agreements provide a more reliable guide to "just, reasonable and nondiscriminatory" than virtually any other evidence. The Commission should utilize such terms and conditions in existing agreements as verification for the proper content of its national rules.

## VII. COLLOCATION

Section II.B.2.b. of the Notice addresses the collocation provisions of section 251. Section 251(c)(6) imposes on incumbent LECs a duty to provide for physical and virtual collocation of competitors' equipment necessary for interconnection. The Notice tentatively concludes that the Commission will adopt national standards to implement this

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[14] See, Notice at para. 50-51.

collocation requirement. Such a step would simplify greatly the process of negotiating collocation requirements and would be consistent with the Commission's recent efforts to establish interconnection and collocation standards for the entire industry.[15]

The Commission has expended significant energy on determining and refining appropriate collocation rules and requirements in its Expanded Interconnection proceedings. These rules and standards should be employed in implementing section 251(c)(6) with appropriate changes to reflect the passage of the 1996 Act.

## VIII. UNBUNDLING

Section II.B.2.c. of the Notice addresses the unbundling requirements of Section 251. Section 251(c)(3) requires incumbent LECs to provide access to network elements on an unbundled basis. Section 251(d)(2) further specifies two factors the Commission must consider as it determines what network elements should be unbundled and made available to requesting carriers. The requirement to offer unbundled network elements to competitors is a cornerstone of the Act's pro-competitive thrust.

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[15] *Special Access Expanded Interconnection Order*, 7 FCC Rcd 7369; *Special Access Physical Collocation Designation Order*, 8 FCC Rcd 6909; *Virtual Collocation Expanded Interconnection Order*, 9FCC Rcd 5154; *Virtual Collocation Designation Order*, 10 FCC Rcd 11116.

Unbundling network elements will ensure a permanent source of competition to incumbent LECs and will supply a crucial bridge for carriers who will develop facilities-based competition over time.

In response to the section 251(c)(3) requirement of unbundling "at any technically feasible point" the Notice proposes unbundling a variety of different elements of the network.[16] The Notice's discussion of unbundled elements is divided into the following four categories: (1) local loops, (2) local switching capability, (3) local transport and special access, and (4) databases and signalling systems. Although some commenters may suggest restricting interconnection to these few categories of network elements, such an interpretation would fall far short of the "technically feasible" standard set in the statute.

The Office of Advocacy supports the Commission's tentative conclusion that "unbundling ... by one LEC (for any carrier) evidences the technical feasibility" of unbundling for other carriers.[17] The Commission is also correct in its tentative conclusion that, once this is demonstrated, LECs should bear the burden of proof that a network element is not technically

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[16]1996 Act at section 101; section 251(c)(3).

[17]Notice at para. 87.

feasible. This is a particularly relevant requirement for smaller competitors with fewer resources, since proving technical feasibility could be a costly and time-consuming undertaking.

If small businesses are to enter this market, unbundling must go beyond the three or four basic elements that some parties may be suggesting. By unbundling at the points discussed in the Notice, the Commission could best facilitate the entry of smaller competitors, allowing them to begin competing in smaller market niches. It would also maximize a smaller competitor's flexibility in fashioning a competitive offering and minimize the unnecessary elements it would need to purchase.

The Commission's unbundling requirements should also evolve over time to reflect changes in technology. The Commission should establish a predictable mechanism to revisit its unbundling requirements in the future. Furthermore, the Commission should explicitly commit to reexamining the effect of its rules on small competitors as an integral part of any periodic reassessment of its rules.

Specifying compliance and enforcement mechanisms is an essential part of any Commission rule on unbundling. Unbundled network elements could be rendered practically useless to competitors without such mechanisms in place. As the Notice

suggests, the most competitively neutral manner of implementing such mechanisms would be to require incumbent LECs to provide installation, service, and maintenance intervals to competitors just as they do for their own customers.[18]

## IX. PRICING

Section II.B.2.d. of the Notice addresses the pricing provisions of section 251. The pricing of unbundled network elements will be the crucial issue determining the success or failure of the 1996 Act's experiment in competition for the local exchange market. As the Notice correctly points out, either unreasonably high or unreasonably low prices will cause inefficient market entry by competitors, with artificially low prices discouraging economic investment and artificially high prices attracting uneconomic investment. There is a growing consensus that forward-looking long-run incremental cost (LRIC) based cost methodologies, and particularly total service long-run incremental cost (TSLRIC) yield prices that most closely approach those of an efficient market. As referenced in the Notice, states such as California, Illinois, Michigan, California and New York have utilized LRIC-based pricing methodologies.[19] The Office of Advocacy therefore recommends the Commission employ the TSLRIC costing methodology.

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[18]Notice at para. 89.

[19]Notice at para. 127.

The Notice also discusses adopting a proxy-based methodology for determining reasonable rates for unbundled network elements. Proxy-based methodologies have always been considered less than ideal by smaller local exchange carriers. Regardless of the specifics of the model, proxies inevitably fail to adequately reflect the actual costs that a great number of smaller carriers face and would work a hardship on them just as they begin to face new competitive pressures. For this reason, the Commission should reject proxy-based rate methodologies.

**X. APPROVED AGREEMENTS**

Section III.B. of the Notice raises the question whether section 252(i) allows other carriers to request individual elements of a previously approved agreement.[20] The Office of Advocacy urges the Commission to answer this query in the affirmative.

The implementation of section 252(i) will have a disproportionate effect on smaller telecommunications carriers' ability to enter and compete in segments of the local exchange market. Smaller competitors must not be forced to pay for unwanted elements when choosing element(s) from previously approved agreements. Barring other carriers from requesting individual elements of an agreement would in many cases exclude

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[20]Notice at para. 271.

smaller competitors from the scope of section 252(i). While larger competing carriers, given their greater resources, would still be able to utilize many or even all of the elements of an approved agreement, smaller competitors would, be foreclosed from requesting any of its elements.

The language of the statute is not ambiguous on this point. Subsection 252(i) states that a LEC shall make available "any interconnection, service, or network element" provided in a state approved agreement.[21] The statute clearly distinguishes between "agreement" and "element".[22] It does not require that an "agreement" be made available but rather that any "element" be made available.

The Notice suggests that this provision may restrict LECs from incorporating legitimate pricing differentials among elements of an agreement that are a part of an overall package. It is important to note, however, that the provisions also restricts LECs from artificially manipulating prices of elements to avoid the effect of this subsection. While this provision may preclude the use of some normal pricing strategies by incumbent LECs and require them to assess the value of individual elements

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[21]1996 Act at 252(i).

[22]The term "element" is defined by section 3(a)(45) of the 1934 Act. 47 U.S.C. Sec. 153(a)(45).

of an agreement, this is not an unreasonable burden and LECs are best situated to undertake this kind of assessment.

This interpretation, while imposing some additional burden on incumbent LECs in negotiating agreements, will help to maximize competition. If a competitor can offer competition on the basis of individual elements of pre-existing agreements, it will speed competition in those market segments, driving all prices towards the most economically efficient level.

The Notice also requested comment on how long an agreement must be made available to competitors. Short of an absence of customer demand, there is no compelling rationale for setting artificial limits to the duration of an agreement. This is an area where incumbent LECs could exercise a significant hardship on competing carriers, requiring them to renegotiate agreements at unreasonably short intervals. This would not just impose an anticompetitive burden on requesting LECs but would also impose significant unnecessary transactional costs, delay and uncertainty on competitors.

## XI. CONCLUSION

The Office of Advocacy respectfully urges the Commission to adopt the foregoing proposals for implementation of the local

competition provisions of the Telecommunications Act of 1996.

Respectfully submitted,

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